Supreme Court, U.S.
FILED

No. 04-___ 031583 MAY 21 2004

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IN THE

Supreme Court of the United States

HANDLEMAN COMPANY,
Petitioner,

v.

CAPITAL FACTORS, INC., KMART CORPORATION, KNIGHT-RIDDER, INC., and IRVING PULP & PAPER, LTD.
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The bankruptcy court authorized Kmart to pay in full 2,327 critical vendors at the inception of its bankruptcy, including $49 million to petitioner Handleman. Respondent Capital Factors appealed the bankruptcy court's order to the district court and gave 36 parties notice of its appeal, but not Handleman or most other critical vendors. The district court reversed and held it was "not too late" for all the critical vendors (including Handleman) to return the money. In the appeal that followed to the court of appeals, Handleman intervened to contest, on jurisdiction and due process grounds, that the district court's decision applied to it. The court of appeals rejected Handleman's arguments, stating: "it is hard to see why it matters whether the district judge's resolution would have had independent effect." The court of appeals then affirmed the district court, and held that Handleman was bound by its decision and that all 2,327 critical vendors must "accept" its decision—even though they had no notice. Kmart has now sued over 1,000 critical vendors, including Handleman, to recover the money it paid them. This petition thus presents the following questions:

1. Whether a district court may reverse as to petitioner a bankruptcy court order by which it was paid $49 million when the district court never acquired personal jurisdiction over petitioner and it was not a party in the district court.

2. Whether the court of appeals violates due process by applying the reversal of a bankruptcy court order to petitioner when petitioner was not a party in the district court and had no notice of the appeal to the district court or the opportunity to participate there.

RULE 29.6 CORPORATE DISCLOSURE

Pursuant to Sup. Ct. R. 29.6, Handleman Company makes the following disclosure:

1. Parent corporations: None

2. Any publicly held company that owns more than 10% of the party's stock: None

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INTRODUCTION

The Seventh Circuit's opinion directly conflicts with the decisions of this Court that hold: (1) a district court cannot bind a person unless it has acquired jurisdiction over that person; and (2) a person must receive notice and the opportunity to be heard, as required by the Due Process Clause of the Fifth Amendment, before a district court may impair its property interests.

It is undisputed that Handleman was never a party to Capital Factor's appeal of the Critical Vendors Order from the Bankruptcy Court to the District Court. Therefore, under this Court's decisions, the District Court's reversal of the

Critical Vendors Order could not bind Handleman or impair its property interests in the $49 million it was paid.

Yet, the Seventh Circuit ignored these fundamental principles. Instead, it affirmed the Critical Vendors Order as to Handleman based on the startling proposition that it "is hard to see why it matters whether the district judge's resolution would have had independent effect." (App at 5a). The Seventh Circuit justified its ruling by contending that: (1) the hearing in the Seventh Circuit somehow cured Handleman's lack of opportunity to be heard in the District Court; (2) Handleman was at fault for not knowing about Capital Factors' appeal because it should have monitored Kmart's bankruptcy after it was paid; and (3) Handleman did not need notice of the District Court appeal and the opportunity to be heard because (unbeknownst to Kmart and Handleman) Kmart supposedly represented the interests of all critical vendors there.

This Court has repeatedly rejected each of the arguments advanced by the Seventh Circuit when they were attempted in other cases. Thus:

1. A Due Process violation is not remedied by a post-deprivation hearing in an appellate court. *See, e.g., Nelson v. Adams, USA, Inc.*, 529 U.S. 460, 466 (2000); *Armstrong v. Manzo*, 380 U.S. 545, 551-552 (1965).

2. A person is not required, as the Seventh Circuit said, to "look out for their own interests and intervene if need be" (App at 6a) when they have not received actual notice of proceedings that may affect them. *See, e.g., Martin v. Wilks*, 490 U.S. 755, 763 (1989); *City of New York v. NY, NH & RR Co.*, 344 U.S. 293 (1953).

3. The requirement for Due Process is not avoided by the argument that a party/debtor (Kmart) represented the interests of a non-party/creditor (Handleman) in the lower court, especially where the non-party never received notice or the

opportunity to be heard concerning the party's purported representation of it. *See, e.g., Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 846, 848 (1999); *Mennonite Bd. of Missions v. Adams*, 462 U.S. 791 (1983).

Unless reversed, the Seventh Circuit's decision will eviscerate the constitutional rights of Handleman and the other 2,327 critical vendors who must "accept" its decision. Most assuredly, the decision will also be used as precedent by parties and courts in other unrelated bankruptcy (and even non-bankruptcy) cases to avoid the basic (and often inconvenient) requirements of jurisdiction, notice, and the opportunity to be heard that collectively form the critical foundation to our judicial system. The Seventh Circuit's decision has enormous adverse consequences, both in the Kmart bankruptcy and generally, because it holds that an appellant need give notice only to the debtor and not to other creditors who have specific individual property interests at risk.

Given these compelling circumstances, Handleman requests that the Court grant *certiorari* and reverse the Seventh Circuit. Handleman asks this Court to hold that the reversal of the Critical Vendors Order did not apply to Handleman, who was not a party in the District Court.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 359 F.3d 866 and reprinted in the Appendix ("App.") at 1a-12a. The opinion of the District Court is reported at 291 B.R. 818 and reprinted at App. 13a-23a. The order of the Bankruptcy Court (App. 24a-32a) is unreported.

JURISDICTION

The Seventh Circuit entered its decision on February 24, 2004, and issued the mandate in five of the nine consolidated appeals on February 24, 2004. A timely petition for rehearing was filed by Irving Pulp & Paper, Ltd. in the remaining four

consolidated appeals, and that petition was denied on May 6, 2004.[1] This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

PERTINENT CONSTITUTIONAL PROVISION AND PROCEDURAL RULE

The Fifth Amendment to the Constitution reads, in relevant part: "No person shall be . . . deprived of life, liberty, or property, without due process of law." U.S. CONST. Amend. V.

Rule 8001(a) of the Federal Rules of Bankruptcy Procedure provides:

> "An appeal from a judgment, order, or decree of a bankruptcy judge . . . shall be taken by filing a notice of appeal with the clerk within the time allowed by Rule 8002. . . . The notice of appeal shall (1) conform substantially to the appropriate Official Form, (2) contain the names of all parties to the judgment, order, or decree appealed from and the names, addresses and telephone numbers of their respective attorneys, and (3) be accompanied by the prescribed fee. Each appellant shall file a sufficient number of copies of the notice of appeal to enable the clerk to comply promptly with Rule 8004."

STATEMENT OF THE CASE

A. The Proceedings In The Bankruptcy Court

1. Kmart's Bankruptcy

On January 22, 2002, Kmart Corporation and its affiliates ("Kmart") filed a voluntary petition for reorganization pursuant to Chapter 11 of the United States Bankruptcy Code

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[1] Knight-Ridder, Inc., a party to the Seventh Circuit appeal, is filing a Petition for Writ of Certiorari at the same time with respect to the Seventh Circuit's resolution of the substantive bankruptcy issues.

in the United States Bankruptcy Court for the Northern District of Illinois. Kmart was the largest retailer to ever file bankruptcy, with more than $10 billion in debt and over 47,000 creditors.

On the first day of its bankruptcy, Kmart filed a Consolidated List of Creditors Holding 50 Largest Unsecured Claims ("Largest Creditors List"). This document identified Handleman as Kmart's 10th largest unsecured creditor, and gave detailed Handleman contact information. (App at 49a-58a).

2. The Critical Vendors Order

On the first day of its bankruptcy, Kmart also filed its Critical Vendors Motion, which sought authority to pay "the prepetition claims of certain critical vendors that are essential to the uninterrupted functioning of the Debtors' business operations."[2] (Seventh Circuit Joint Appendix ("JA") 112). Handleman was one of just two critical vendors that Kmart named in its motion. All critical vendors, other than Handleman and Fleming Companies, were identified only by category (e.g., "egg vendors"). (JA 120-21).

On January 25, 2002, after hearing testimony, the Bankruptcy Court granted Kmart's motion and entered its Critical Vendors Order that authorized Kmart:

> "in the reasonable exercise of [its] business judgment, to pay all, a portion or none of the prepetition claims . . . of the following Critical Vendors: ~~(a)~~ Fleming Companies, Inc.; (b) ***Handleman Company***; (c) vendors who supply eggs and dairy and (d) certain . . . vendors who supply goods and services related to [Kmart's] advertising program." (App. 25a (emphasis added)).

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[2] Motions to pay critical vendors arise with some frequency in Chapter 11 cases in circumstances where the debtor is not able to successfully reorganize unless certain critical vendors continue to supply goods to the debtor.

Once again, the Critical Vendors Order specifically identified Handleman by name.

3. Kmart Pays Handleman $49 Million

On February 1, 2002, Kmart paid Handleman $49 million pursuant to the authority granted it by the Critical Vendors Order. (JA 10-11, 384-85). In exchange for this payment, as required by the Critical Vendors Order, Handleman agreed to extend additional post-petition credit to Kmart, to supply critical goods and services during Kmart's bankruptcy case, and to forgo its reclamation or lien claims against Kmart.[3] (App. 29a-32a). In total, Kmart made payments to 2,327 critical vendors. (App. 6a).

4. Capital Factors' Notice of Appeal

On February 1, 2002, one creditor named Capital Factors, Inc. ("Capital Factors") filed in the Bankruptcy Court its Notice of Appeal to the District Court from the Critical Vendors Order.[4] (App. 33a). No other creditor appealed the Critical Vendors Order.

Fed. R. Bankr. P. 8001(a) mandates that notices of appeal from the bankruptcy court to the district court "shall . . . contain the names of all parties to the judgment, order, or decree appealed from." In addition, in the Kmart case, the Bankruptcy Court had issued an "Order . . . Establishing . . . Certain Notice, Case Management And Administrative Procedures" (the "Notice Procedures Order") that mandated

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[3] The Bankruptcy Code at 11 U.S.C. § 546(c)(2) recognizes a seller's statutory or common law right to reclaim goods sold while the debtor was insolvent. The bankruptcy court cannot deny a valid reclamation claim unless it grants the seller a lien or an administrative expense claim under 11 U.S.C. § 503(b).

[4] The District Court had subject matter jurisdiction pursuant to 28 U.S.C. §158(a).

that "[a]ll filings shall be served on any entity with a particularized interest in the subject of the filing." (App.41a).

Nevertheless, appellant Capital Factors did not name Handleman in its Notice of Appeal as a party. Instead, Capital Factors identified only 36 persons as parties to its appeal. (App at 33a-38a). Capital Factors chose not to name Handleman even though Handleman was specifically identified in both the Critical Vendors Order and the Critical Vendors Motion as having a "particularized interest" in the matter, and its contact information was readily available from the Largest Creditors List.

The clerk of the Bankruptcy Court served Capital Factors' Notice of Appeal on the 36 parties it had identified. Fed. R. Bankr. P. 8004. Because Capital Factors did not identify Handleman in its Notice of Appeal or comply with the Notice Procedures Order, Handleman was not served with Capital Factors' Notice of Appeal.

B. The Proceedings In The District Court

1. The Appeal Briefs In The District Court Focused On Whether The Critical Vendors Order Should Be Reversed As To Handleman

Capital Factor's brief in the District Court expressly discussed why, in its view, Handleman should not be treated as a critical vendor. Kmart's brief likewise specifically focused on Handleman and explained why it was a critical vendor. Thus, Handleman's "fate" was being argued by both sides without Handleman being notified or aware of it.

2. The District Court Was Unaware That Handleman Had Not Received Notice

The District Court specifically asked Capital Factors whether the critical vendors were "entitled to be heard" in connection with its appeal. In response, Capital Factors led

the District Court to believe that Capital Factors had notified all critical vendors that it knew about. (JA 41). This was not true, as Capital Factors knew Handleman's identity and that it had not been served with notice of Capital Factors' appeal. Thus, the District Court was concerned about whether notice had been given, but was unaware that Handleman had not received notice of Capital Factors' appeal.

3. Handleman Was Unaware Of The District Court Proceedings

Handleman was unaware of the District Court proceedings and did not know that Capital Factors had appealed the Critical Vendors Order or that the $49 million it had been paid was at risk. (JA 11).

4. The District Court's Decision

On April 8, 2003, "[a] little more than 14 months [after Capital Factors filed its Notice of Appeal], after all of the critical-vendors had been paid and as Kmart's plan of reorganization was on the verge of approval, [the] District [Court] reversed the order authorizing payment" to the critical vendors. (App. 3a). The District Court also held that it was "not too late to order that the monies be returned" to Kmart. (App. 21a).

5. Handleman Learns Of The District Court Proceedings

On April 10, 2003, Handleman learned from a third party that the Critical Vendors Order had been appealed to and reversed by the District Court. (JA 11).

C. The Proceedings In The Bankruptcy Court After The District Court's Opinion

1. The Amended Plan

Under its proposed First Amended Plan of Reorganization (the "Original Plan"), Kmart expressly waived any right to

recover critical vendor payments from the recipients. (JA 344-45 at art. 7.14). Kmart's creditors overwhelmingly approved the Original Plan.

However, on April 10, 2003—just two days after the District Court's critical vendors decision—Kmart proposed an amendment to the Original Plan (the "Amended Plan"). Under the proposed Amended Plan, Kmart (i) rescinded its waiver and (ii) was authorized to sue to recover all the payments it made pursuant to the Critical Vendors Order. (JA 368-369, 375 ¶ 54(af)). The Amended Plan also provided that all recovered critical vendor payments be paid to the *reorganized Kmart* where they would, in effect, provide additional working capital for the reorganized venture. (JA 343).

On April 23, 2003, the Bankruptcy Court, without another vote of the creditors, confirmed Kmart's Amended Plan that authorized the *reorganized Kmart* to recover the critical vendor payments for itself. (JA 368-69, 375).

Under the Amended Plan, creditors received stock in the reorganized Kmart allocated *pro rata* based on the amount of their allowed claims. (JA 378-79 at arts. 1.152, 5.5). Kmart has implemented its Amended Plan and the creditors have largely received their stock.

However, the Amended Plan made no provision for the claim of any critical vendor who is forced to return the critical vendor payment it received—and the deadline for filing pre-petition proofs of claim by these unsecured creditors expired long ago on July 31, 2002. (JA 377 at art. 1.15).

Handleman never filed a pre-petition proof of claim because it already had been paid its $49 million and did not know of Capital Factors' appeal. Had Handleman not received its $49 million critical vendor payment, it would have: filed a prepetition proof of claim (before the time to do so

expired); likely been a member of the unsecured creditors' committee; helped shape Kmart's reorganization plan; and received shares in the reorganized Kmart that have since tripled in value.[5]

2. Kmart Sues Handleman For The $49 Million

On June 24, 2003, Kmart sued Handleman in the bankruptcy court in an adversary proceeding to recover the $49 million it paid.[6] Kmart issued a press release when it filed suit stating: "Kmart does not believe that any defenses that may be asserted by Handleman will prevent a recovery of money by Kmart."[7]

D. The Proceedings In The Seventh Circuit

On April 10, 2003, Kmart appealed the District Court's reversal of the Critical Vendors Order to the United States Court of Appeals for the Seventh Circuit.[8] On May 1, 2003, Handleman filed a motion to intervene in the appeal arguing: its rights had been violated by the District Court deciding its fate without notice to Handleman or an opportunity for it to be heard; and its interests were not represented in the appeal because Kmart's interests were clearly adverse to Handleman.

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[5] This Court may take judicial notice of the fact that the stock of the reorganized Kmart began trading on April 30, 2003 under the symbol KMRT at an initial price of $15.00 per share and closed at a price of $44.30 per share on May 14, 2004, a 295% increase. Fed. R. Evid. 201.

[6] *See* JA 413-418 (*Kmart Corporation v. Handleman Company,* Complaint Against Handleman Company to Avoid Transfer of Property and for Recovery, Adv. Proc. #03A02130 (Bankr. N.D. Ill.).

[7] This press release may be found at www.kmartcorp.com/corp/story/pressrelease/news/pr030630.stm.

[8] The Seventh Circuit had subject matter jurisdiction pursuant to 28 U.S.C. §158(d).

The next day, the Seventh Circuit granted Handleman's intervention motion.[9]

On February 24, 2004, the Seventh Circuit affirmed the District Court's reversal of the Critical Vendors Order. The Seventh Circuit's opinion did not directly address Handleman's argument that the District Court lacked jurisdiction over it. The Seventh Circuit instead focused on and rejected Handleman's Due Process arguments.

The Seventh Circuit offered three reasons why Handleman's omission from the District Court proceedings did not violate the Due Process Clause. First, the Circuit Court concluded that, in light of Handleman's intervention in the Seventh Circuit appeal, it "will be bound by *our* decision, so it is hard to see why it matters whether the district judge's resolution would have had independent effect." (App. 5a) (emphasis in original). Second, the court faulted Handleman for not discovering Capital Factors' appeal on its own, because "creditors must look out for their own interests and intervene if need be—as Handleman could have done had it devoted to these proceedings the care that a $49 million stake warrants." (App. 6a). Third, it held that "Kmart vigorously represented the interests of Handleman and the other vendors Kmart deemed 'critical'" and, therefore, Capital Factors only needed to give Kmart notice of its appeal. In effect, the Seventh Circuit held that Capital Factors gave more notice than was required when it notified 35 other parties (in addition to Kmart) of its appeal.

The Seventh Circuit also concluded that, "[a]s a party before this Court, Handleman will not be allowed to contest matters resolved here." (App. 6a). In fact, the Seventh Circuit emphasized that "even the 2,327 critical vendors that are

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[9] At the time Handleman intervened, there were five consolidated appeals. Irving Pulp & Paper, Ltd. later filed four additional notices of appeal that were consolidated with the earlier five.

not parties in this court must accept the precedential effect of our decision" in any subsequent adversary proceeding against them to recover the payments they received. (App. 6a).

E. The Proceedings In The Bankruptcy Court After The Seventh Circuit's Decision

Following the Seventh Circuit's decision, Kmart proceeded with adversary proceedings in the Bankruptcy Court against more than 1,000 critical vendors to recover the critical vendor payments made to them. The Seventh Circuit's decision mandates that the critical vendors "accept" the invalidity of the Critical Vendors Order in each of these suits.[10]

REASONS FOR GRANTING THE PETITION

I. THE DISTRICT COURT HAD NO PERSONAL JURISDICTION OVER HANDLEMAN AND ITS REVERSAL OF THE CRITICAL VENDORS ORDER MAY NOT BE APPLIED TO HANDLEMAN

It is fundamental that a court cannot bind a person to a decree or judgment unless it first acquires personal jurisdiction over them. *Martin v. Wilks*, 490 U.S. 755, 761, 763 (1989), makes this basic point:

> "All agree that it is a principle of general application in Anglo-American jurisprudence that one is not bound by a judgment *in personam* in a litigation in which he is not designated as a party or to which he has not been made a party by service of process.
>
> * * * *

[10] *See* May 6, 2004 Order in Kmart's bankruptcy (Case #B202474) that identifies these cases and establishes case management procedures for them.

> Unless duly summoned to appear in a legal proceeding, a person not privy may rest assured that a judgment recovered therein will not affect his legal rights." (citations omitted).

As this Court further emphasized in *Richards v. Jefferson County*, 517 U.S. 793, 798 (1996):

> "This rule is part of our deep-rooted historic tradition that everyone should have his own day in court. As a consequence, a judgment or decree among parties to a lawsuit resolves issues as among them, but it does not conclude the rights of strangers to those proceedings." (citations omitted).

It is undisputed that Handleman was not a party to Capital Factors' appeal of the Critical Vendors Order in the District Court. Under this Court's decisions, the District Court thus did not have jurisdiction over Handleman and had no power to decide any issue that would bind Handleman with respect to the $49 million it received. The only persons bound by the District Court's decision were the 36 parties that Capital Factors named in its Notice of Appeal.

The Seventh Circuit never directly addressed Handleman's jurisdiction argument. Instead, it concluded that it did not matter whether the District Court's decision had independent effect because Handleman had intervened in the Seventh Circuit. (App at 5a).

Contrary to what the Seventh Circuit said, it is enormously important whether the District Court had jurisdiction over Handleman. This Court's jurisdiction decisions have repeatedly held that a decision on the merits cannot stand and the slate must be wiped clean when the lower court did not have jurisdiction. *Helicopteros Nacionales De Colombia, S.A. v. Hall*, 466 U.S. 408 (1984), illustrates the point. There, after the defendant's dismissal motion for lack of personal jurisdiction was denied, it actively defended, but lost at trial both on the plaintiff's claim and its cross-claim against another party.

The defendant then appealed the judgment against it, claiming the trial court lacked personal jurisdiction over it. This Court agreed, reversed the judgment against the defendant, and eliminated the decision on the merits against it. *See Peralta v. Heights Medical Center, Inc.*, 485 U.S. 80, 87 (1988)("wiping the slate clean" is only appropriate remedy); *Armstrong v Manzo*, 380 U.S. 545, 552 (1965) (same).[11]

Handleman now asks this Court to "wipe[] the slate clean" as to it (and the other 2,327 critical vendors who never received notice). The District Court had no jurisdiction over Handleman and, as a result, the Seventh Circuit could not retroactively bind Handleman to the reversal of the Critical Vendors Order.

II. HANDLEMAN'S DUE PROCESS RIGHTS WERE VIOLATED

Handleman intervened in the Seventh Circuit to point out that what transpired in the District Court could not bind it. The Seventh Circuit brushed off Handleman's arguments and held, in effect, that Handleman's challenge to what happened in the District Court bound it to what the District Court did when Handleman was not there. The Seventh Circuit's decision cannot be squared with the basic requirements of Due Process—notice and opportunity to be heard—and directly conflicts with this Court's decisions.

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[11] *Torres v. Oakland Scavenger Co.*, 487 U.S. 312 (1988), makes a similar point in the opposite situation. There, a group of plaintiffs appealed an unfavorable decision, but failed to name one of them in their notice of appeal. The Court of Appeals reversed, but the plaintiff who was not named in the appeal did not get the benefit of the reversal. Under the rules then in effect, the failure to name the one plaintiff made him a non-party to the appeal and the adverse lower court decision was final and binding as to him. Here, as in *Torres*, the reversal of the Critical Vendors Order should not be applied to Handleman because it was not a party to the District Court appeal. *See Becker v Montgomery*, 532 U.S. 757, 767 (2001)(endorsing the continuing vitality of *Torres*' logic).

A. Handleman's Due Process Rights Were Violated In The District Court

1. *Handleman Was Denied Notice And The Opportunity To Be Heard*

It is undisputed that Handleman did not receive notice of Capital Factors' appeal and did not learn of the appeal until after the District Court reversed the Critical Vendors Order.

Unquestionably, Handleman's property interests were at stake in the District Court proceedings. After all, Capital Factors was attempting to invalidate the Critical Vendors Order and obtain the return of all critical vendor payments, including the $49 million paid Handleman. Handleman's property interest in retaining the $49 million was clear and enormous. *Board of Regents of State Colleges v. Roth*, 408 U.S. 564, 571-2 (1972) ("property interests" include and "extend well beyond actual ownership of real estate, chattels, or money"); *Tulsa Professional Collection Services, Inc. v. Pope*, 485 U.S. 478, 485 (1988) (an intangible interest, including an unsecured claim, constitutes a protected property interest); *Connecticut v. Doehr*, 501 U.S. 1, 12 (1991) (Due Process protections apply to impairment of property rights); *Mennonite Bd. Of Missions v. Adams*, 462 U.S.791, 798-99 (1983) (finding Due Process violation where mortgagee were not notified of tax sale, even though sale would only diminish, not extinguish, its mortgage interest); *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 313 (1950) (proceeding which diminishes property interest "must measure up to the standards of due process").

"[I]ndividuals whose property interests are at stake are entitled to notice and an opportunity to be heard." *Dusenbery v. United States*, 534 U.S. 161, 167 (2002) (citations omitted). *See Lachance v. Erickson*, 522 U.S. 262, 266 (1998) ("The core of due process is the right to notice and a meaningful opportunity to be heard"). Therefore, the District Court could

not impair Handleman's right to retain its $49 million unless Handleman was first afforded the notice and opportunity to be heard that Due Process requires. *Roth*, 408 U.S. at 571-72 (ownership is the quintessential property right).

In the seminal case of *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950), this Court established what Due Process requires:

> "[T]here can be no doubt that at a minimum [the Due Process Clause] require[s] that deprivation of life, liberty or property by adjudication be preceded by notice and opportunity for hearing appropriate to the nature of the case. . . . An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the action and afford them an opportunity to present objections." 339 U.S. at 313-14 (citations omitted).

In *Mullane*, the Court held that Due Process was not satisfied through notice by publication when a party's name and address were known. As the Court explained, "[w]here the names and post office addresses of those affected by a proceeding are at hand, the reasons disappear for resort to means less likely than the mails to apprise them of its pendency." *Id.* at 318.

"Since *Mullane* was decided, [this Court has] regularly turned to it when confronted with questions regarding the adequacy of the method used to give notice." *Dusenberry*, 534 U.S. at 167-68. *See Mennonite*, 462 U.S. at 800 ("This Court has adhered unwaveringly to the principle announced in *Mullane*").

Applying these principles in *City of New York v. New York, N.H. & H. R.R. Co.*, 344 U.S. 293 (1953), this Court, in the bankruptcy context, held that a creditor whose identity and address were known was not bound by a claims bar date

where that creditor was not specifically given notice of the bar date.

In short, long-established principles and fundamental Due Process required that Handleman (whose identity and contact information were contained in the Largest Creditors List and the Critical Vendors Order) be given notice of Capital Factors' appeal to the District Court before Handleman's property right to $49 million could be impaired by the District Court. Yet, in violation of Handleman's Due Process rights, Handleman was not given notice even though Capital Factors knew Handleman's name and address.

2. *The District Court's Decision Was Void As To Handleman*

"A judgment rendered in violation of due process is void." *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 291 (1980). In such a circumstance, the judgment must be vacated to "restore[] the petitioner to the position he would have occupied had due process of law been accorded to him in the first place." *Armstrong v. Manzo*, 380 U.S. at 551-52 (1965). *See Peralta v. Heights Medical Center, Inc.*, 485 U.S. at 86-87 (slate must be wiped clean); *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322, 327 n.7 (1979) ("It is a violation of due process for a judgment to be binding on a litigant who was not a party or a privy and therefore has never had an opportunity to be heard").

As to Handleman, therefore, the Seventh Circuit should have vacated the District Court's judgment and returned Handleman to the position it would have occupied if its Due Process rights had been accorded it in the first place.[12]

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[12] The District Court did have jurisdiction over the 36 parties that were given notice of Capital Factors' appeal to the District Court and, as to them, the Seventh Circuit could decide the merits of the Critical Vendors Order.

B. The Seventh Circuit's Reasons For Affirming The District Court Judgment As To Handleman Are Directly Contrary To Numerous Decisions Of This Court

1. *The Due Process Violation Was Not Cured When Handleman Had A Hearing In The Seventh Circuit*

The Seventh Circuit saw no problem with Handleman's Due Process rights being skipped at the District Court stage, apparently because it concluded that any violation was cured by granting Handleman a hearing in the Seventh Circuit. However, this Court has rejected the notion that the skipping of a step in the judicial review process is consistent with Due Process.

A post-deprivation appellate review does not "cure" an earlier Due Process violation. *Nelson v. Adams, USA, Inc.*, 529 U.S. 460, 466 (2000) ("Appeal after judgment [that is entered in violation of Due Process] did not provide an adequate opportunity to defend against the imposition of liability"); *Fuentes v. Shevin*, 407 U.S. 67, 82 (1972) ("no later hearing . . . can undo . . . [the] due process" violation"); *Armstrong*, 380 U.S. at 552 (post-deprivation hearing does not "cure" a Due Process violation[13]; remedy is to "restore[] the petitioner to the position he would have occupied had due process of law been accorded to him in the first place").[14]

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[13] In *Armstrong*, this Court held that even the trial court could not "cure [the decree's] constitutional invalidity" by granting a hearing on a motion to set it aside, because such a motion improperly placed the burden on the victim. 380 U.S. at 550-551.

[14] One rationale for this rule stems from the benefits of the adversary system. "No better instrument has been devised for arriving at truth than to give a person in jeopardy of serious loss notice of the case against him and opportunity to meet it." *United States v. James Daniel Good Real Property*, 510 U.S. 43, 55 (1993) (quoting *Joint Anti-Fascist Refugee*

Three of this Court's more recent decisions enforce the rule that appellate review does not remedy a Due Process violation in a lower court. In *Richards v. Jefferson County*, 517 U.S. 793 (1996), for example, the plaintiffs were citizens who brought a class action to challenge a county tax ordinance levied against them. The state court barred the claim on res judicata grounds, because officials from the local government had already unsuccessfully raised the same challenges to the ordinance in a prior lawsuit. This Court unanimously reversed, citing the deeply rooted rule that all parties are entitled to their day in court. This Court:

> "beg[a]n by noting that the parties to the [prior] case failed to provide petitioners with any notice that a suit was pending which would conclusively resolve their legal rights. That failure is troubling because, as we explained in *Mullane* . . ., the right to be heard ensured by the guarantee of due process has little reality or worth unless one is informed that the matter is pending and can choose for himself whether to appear or default, acquiesce or contest." 517 U.S. at 798 (quotations omitted).

This Court's unanimous decision in *Nelson v. Adams USA, Inc.*, 529 U.S. 460 (2000) also illustrates the point. There, judgment was entered against Nelson's one-man corporation that was the sole defendant. Concerned about collectability, the plaintiff secured the district court's approval to amend the pleadings after the judgment to add Nelson individually as a defendant, and then immediately also entered judgment against him without ever giving him an opportunity to

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Comm. v. McGrath, 341 U.S. 123, 170-172 (1951) (Frankfurter, J., concurring)). "Our deep-rooted historic tradition that everyone should have his own day in court draws from clear experience with the general fallibility of litigation and with the specific distortions of judgment that arise from the very identity of the parties." 18A Wright, Miller & Cooper, FED PRAC & PROC: JURIS 2D § 4449, at 346-48.

respond. Nelson appealed and the Federal Circuit affirmed, reasoning that the result would not have changed if Nelson had been provided an opportunity to be heard before judgment was entered against him. This Court reversed, finding the ultimate result irrelevant to the existence of a Due Process violation and the appropriate remedy:

> "[T]he Federal Circuit reasoned that nothing much turned on whether the party opposing Adams' claim for costs and fees was OCP or Nelson. * * * We neither dispute nor endorse the substance of this speculation. We say instead that judicial predictions about the outcome of hypothesized litigation cannot substitute for the actual opportunity to defend that due process affords every party against whom a claim is stated." 529 U.S. at 471.

Nelson's application to this case is clear: it is irrelevant that Handleman received a hearing in the Seventh Circuit or that the District Court might have reached the same conclusion if Handleman had participated in those proceedings. Handleman did not receive notice of the District Court proceedings and, therefore, did not receive the process it was due. The District Court's decision was void as to Handleman and, as a result, the Seventh Circuit had no power to bind Handleman to the reversal of the Critical Vendors Order.

To like effect is this Court's unanimous decision[15] in *Peralta v. Heights Medical Center, Inc.*, 485 U.S. 80 (1988). There, a default judgment was entered against a defendant who was never properly served. The state courts refused to set aside the default because the defendant had no defense to the plaintiff's claim. In reversing this Court declared:

> "The Texas courts . . . held . . . that to have the judgment set aside, appellant was required to show that he had a meritorious defense, apparently on the ground that

[15] Justice Kennedy did not participate.

> without a defense, the same judgment would again be entered on retrial and hence appellant had suffered no harm from the judgment entered without notice. But this reasoning is untenable. As appellant asserts, had he had notice of the suit, he might have impleaded the employee whose debt had been guaranteed, worked out a settlement, or paid the debt. He would also have preferred to sell his property himself in order to raise funds rather than to suffer it sold at a constable's auction.
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> '[I]t is no answer to say that in his particular case due process of law would have led to the same result because he had no adequate defense upon the merits." . . . As we observed in *Armstrong v. Manzo*, *supra*, at 552, only "wip[ing] the slate clean . . . would have restored the petitioner to the position he would have occupied had due process of law been accorded to him in the first place." 485 U.S. at 85, 87.

As these cases demonstrate, only "wip[ing] the slate clean" restores Handleman to the position it would have occupied. In this case, "wip[ing] the slate" clean requires that this Court hold that the reversal of the Critical Vendors' Order did not apply to Handleman—or to any of the other critical vendors who did not get notice of Capital Factors' appeal to the District Court.

The consequences of not reversing the Seventh Circuit are enormous here. Unless reversed, the Seventh Circuit's decision will encourage Due Process violations at every level of the judicial system. Moreover, when these violations are discovered, they will be treated as mere harmless error that can be cured by an appellate court providing a hearing at which the victim of the Due Process violation has the burden of overturning the decision made in its absence without the opportunity to build a record below. Thus, under the Seventh

Circuit's decision, Due Process "rights" need not be respected and can be easily circumvented.

2. *The Seventh Circuit Wrongly Blamed Handleman For Not Discovering Capital Factors' Appeal*

The Seventh Circuit placed the blame on Handleman for not discovering Capital Factors' Notice of Appeal: "[o]ther creditors must look out for their own interests and intervene if need be—as Handleman could have done had it devoted to these proceedings the care that a $49 million stake warrants." (App. 6a). The Seventh Circuit thus concluded that it was Handleman's own fault for not knowing about Capital Factors' appeal. Once again, this conclusion cannot be squared with this Court's decisions.

In *City of New York v. NY, NH & H RR Co.*, 344 U.S. 293 (1953), this Court expressly declared that the Due Process Clause entitles creditors to reasonable notice from a bankruptcy court before they will be bound—even where they knew of the bankruptcy proceedings and did not monitor them. There, the City of New York knew that the railroad was in bankruptcy, but it did not appear in the proceedings. Only creditors who appeared were given actual notice of the bar date for filing claims. As a result, even though the railroad debtor was aware that the City of New York was a creditor, it did not give the City of New York notice of the bar date for filing its claim, and the City of New York did not otherwise monitor the proceedings to independently learn this information. The Court held the bar date did not bind New York:

> "Nor can the bar order against New York be sustained because of the city's knowledge that reorganization of the railroad was taking place in the court. The argument is that such knowledge puts a duty on creditors to inquire for themselves about possible court orders limiting the time for filing claims. But even creditors who have

> knowledge of a reorganization have a right to assume that the statutory 'reasonable notice' will be given them before their claims are forever barred." 344 U.S. at 297.

The Court has never wavered from this reasoning. *See, e.g., Mennonite Bd. of Missions*, 462 U.S. at 799 ("a party's ability to take steps to safeguard its interests does not relieve the State of its constitutional obligation" to serve notice); *Martin v. Wilks*, 490 U.S. at 763 (no duty to intervene where a party is entitled to notice and a hearing before its rights are affected); *Richards v. Jefferson County*, 517 U.S. at 798 (same).

By faulting Handleman for not monitoring the Kmart proceedings and discovering for itself Capital Factors' appeal of the Critical Vendors Order, the Seventh Circuit imposed on Handleman the precise affirmative duty that *City of New York* and this Court's other cases reject. The rule of *City of New York* is that creditors who are aware of ongoing bankruptcy proceedings have no duty to continuously monitor them for events that may affect their interests. The Due Process Clause requires that actual notice be given before rights may be impaired. The Seventh Circuit's insistence that "creditors must look out for their own interests and intervene if need be" flies in the face of this Court's decisions. *See Martin v Wilks*, 490 U.S. at 765 ("Joinder as a party, rather than knowledge of a lawsuit and opportunity to intervene, is the method by which potential parties are . . . bound by a judgment or decree").

3. *The Due Process Violation Was Not Cured By Kmart's Purported "Virtual Representation" Of Handleman In The District Court*

In contradiction to its argument that Handleman should have "look[ed] out for its own interests," the Seventh Circuit reversed course, and then made the completely opposite argument that "Kmart vigorously represented the interests of

Handleman and the other vendors Kmart deemed 'critical'" in the District Court appeal. (App. 6a). Therefore, according to the Seventh Circuit, notice to Handleman was not necessary.[16]

However, a trustee in bankruptcy does not have standing to assert the claims of individual creditors. *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972) (trustee has differing interests and lacks the standing to assert claim of individual creditor).

In addition, as explained in *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 846 (1999), the concept of virtual representation is an exception to the general rule that "everyone should have his own day in court." This exception has limited applicability and "the burden of justification rests on the exception." *Id.*

Virtual representation is never permitted without notice. Thus, Kmart could not represent Handleman's interests without providing notice to Handleman and affording it the opportunity to participate. *See Mullane v Central Hanover*, 339 U.S. at 315 (1950)(trustee must give notice to beneficiaries that their rights are before court).

In the class action context, where representation issues are most commonly raised, absent class members generally cannot be represented by class representatives unless they first receive the required notice and opportunity to participate. As *Ortiz* teaches:

> "[B]efore an absent class member's right of action was extinguishable due process required that the member

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[16] Capital Factor's own actions were contrary to this holding because it named 36 persons as parties in its Notice of Appeal—an action that would be unnecessary if Kmart represented all creditors. JA 271-280. Of course, if the Seventh Circuit's holding were accepted, it would mean that Capital Factors itself had no right to appeal the Critical Vendors Order (or to have challenged it in the bankruptcy court) because Kmart also represented Capital's interests as a creditor. This makes no sense.

> receive notice plus an opportunity to be heard and participate in the litigation, and . . . at a minimum . . . an absent plaintiff [must] be provided with an opportunity to remove himself from the class." 527 U.S. at 848 (quotations omitted).

The same protection must be afforded to those who are the subject of a "virtual" representation argument. But Handleman here never received notice that Kmart was purporting to represent its interests and never had the opportunity to decide whether to participate. Therefore, there can be no virtual representation here.[17]

Moreover, Kmart had no authority on appeal to represent Handleman's *individual* right to retain the $49 million it received. Even the Seventh Circuit agreed initially here that Kmart did not represent Handleman's individual interests. After all, it granted Handleman's motion to intervene that was based on Kmart's divergent interests. "It would indeed be strange procedure to declare, on one hand, that [the party] adequately represents the interests of the [nonparty] . . ., and then, on the other hand, to require intervention in order to

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[17] Kmart never even contended that it acted as Handleman's representative. The Seventh Circuit was also just mistaken (and in conflict with its own decisions) when it contended Kmart could act as Handleman's representative for its *individual* interest in retaining the $49 million it received. All creditors are supposed to receive notice of important events in a bankruptcy so that creditors can protect their individual interests and object to what the debtor intends to do. Bankruptcy Rule 2002(a)(f). The debtor in possession as trustee owes its obligations to the estate and creditors *collectively*, but it does not *and cannot* represent the interests of individual creditors. *Fisher v. Apostolou*, 155 F.3d 876, 880 (7th Cir. 1998) (trustee represents interests of creditors "as a whole" and "has no standing to bring personal claims of creditors"); *Steinberg v. Buczynski*, 40 F.3d 890, 893 (7th Cir. 1994) ("[T]he trustee . . . has no right to enforce entitlements of a creditor"); *In re Vitreous Steel Products Co.*, 911 F.2d 1223, 1231 (7th Cir. 1990) (individual creditors have interests separate and apart from the interests of the estate as a whole).

insure of this representation in fact." *Sam Fox Publishing Co., Inc. v. United States*, 366 U.S. 683, 691-92 (1961).

Clearly, Kmart and the critical vendors, including Handleman, did not have identical interests. Once Kmart secured the initial flow of goods from its critical vendors, it had no interest in defending the critical vendor payments. In fact, it had a huge interest in the reversal of the Critical Vendors Order and the recovery of these payments so they could provide additional cash flow to the *reorganized* Kmart. Thus, within days of the District Court's opinion, Kmart obtained approval for its Amended Plan whereby the *reorganized* Kmart was authorized to recover these payments for itself. It then quickly sued Handleman to recover the $49 million and announced in a press release that Handleman had no defense. It even elected not to make any oral argument to the Seventh Circuit in support of the Critical Vendors Order. After Kmart got the benefit of the Critical Vendors Order at the inception of the bankruptcy, its interests were radically different from those of the critical vendors. *See Mennonite*, 462 U.S. at 799 (even where mortgagor and mortgagee had the same interest in preserving their rights to real estate, notice to the mortgagor cannot be deemed notice to mortgagee).

A divergence of interest *at any point* in the judicial review process—even on appeal—also renders "virtual representation" inadequate for due process purposes. "[T]he Due Process Clause of course requires that the named plaintiff *at all times* adequately represent the interests of the absent class members." *Phillips Petrol. Co. v. Shutts*, 472 U.S. 797, 812 (1985) (emphasis added).

Under the circumstances, Kmart could not represent Handleman's *individual* interest in retaining the $49 million it was paid and could not represent Handleman in any context without first providing notice to Handleman and affording Handleman the opportunity to represent itself.

CONCLUSION

Handleman requests that the Court: grant *certiorari*; reverse the Seventh Circuit; and hold that the reversal of the Critical Vendors Order did not bind Handleman or the other 2,327 critical vendors who did not receive notice of Capital Factors' appeal and were not parties in the District Court.

Respectfully submitted,

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May 21, 2004